

WISCONSIN'S REVENUE GAP

**An analysis of corporate
tax avoidance**

Institute for Wisconsin's Future
December 2011

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Executive Summary

Wisconsin is in transition, rebuilding the economy to adopt 21st century technologies and attract both investors and creative professionals. However, the new criteria for choosing where to do business and draw top employees are increasingly based on quality of life factors. These are factors that include good schools, a clean environment, safe and stable neighborhoods, easy transport, as well as diverse recreational and cultural resources. A high quality of life is based primarily on a strong, well-managed system of public structures ensuring that each vital aspect of life and commerce is supported.

Budget shortfalls at the state and local level, however, have created a situation where there is inadequate funding to maintain good services even with increased property tax contributions.

Wisconsin families are paying higher property taxes each year for diminishing services. Bitter conflicts among local taxpayers, public sector advocates, local officials and public employees have escalated as the choice between higher property taxes and service cuts becomes more unacceptable. It is a false choice, however, one premised on the notion that there is no other source of revenue to cover the cost of public structures.

There is indeed a pool of untapped revenue in Wisconsin — uncollected corporate taxes. “Corporate tax leakage” describes the loss of state corporate income tax due to large companies’ tax avoidance using tax breaks, loopholes and profit shelters. This leakage cost Wisconsin \$643 million in 2006. Overall, Wisconsin’s corporate sector fell \$1.3 billion short on its payments of all state and local taxes, compared to what it would have paid if it had supported public programs at the average level among corporations nationwide.

Almost fifty thousand corporations filed tax returns with the Wisconsin Department of Revenue in 2005. Two out of three returns showed a bottom-line tax of zero dollars. Research on individual companies found the same level of avoidance among national brand name companies. In 2005, for example, Microsoft, Merck and Sears earned a combined \$18 billion in profits — surely some of which came from Wisconsin consumers — but paid a combined zero in Wisconsin corporate income tax.

This report focuses on the largest corporations in the state—multi-state, multi-national companies with publicly held stocks. Many of these megabusinesses use various mechanisms to move their profits out of Wisconsin to states that do not collect corporate income taxes.

It is difficult to find and discuss corporate tax data because state law provides a screen to protect this information from public scrutiny. However, as the crisis in financing local, state and educational systems becomes more serious, jeopardizing the common good both now and in the future, it is vital to examine ways to expand the resource base for public operations and state development.

The first step in this effort is to ensure public disclosure of all the tax facts relevant to building a strong and balanced revenue system. This requires a reform of state laws that currently shield too much corporate tax information. Financial transparency is needed to make informed decisions about the impact of existing tax policies and address those aspects of the tax system that are resulting in inadequate revenues or an unfair distribution of tax responsibility. When this information is fully disclosed, policymakers and the public can decide what policies should be adopted to give this state and its residents the optimum opportunity for stability and success.

Introduction

Wisconsin is embarked on an economic transformation from farm and factory to 21st century technologies and diverse information services. The state's capacity to transition successfully requires a strong foundation of effective public structures. Historically, Wisconsin's reputation for quality education, safe communities, a clean environment and a wide range of community services brought businesses and families to settle in the area.

Now, as the state competes for biotech companies, green product manufacturers and talented workers, the public sector plays an even greater role in attracting and keeping new industries and skilled young people. Corporate leaders are vocal about the need for top-notch schools, good transportation, family-friendly neighborhoods and access to culture and recreational resources. Increasingly, quality of life factors are the criteria used by investors seeking to build or expand facilities.

Ironically, at a time when the physical and social infrastructure is so crucial, many Wisconsin communities are facing erosion in the very public structures that could determine future prosperity. The list of systems in some stage of crisis is long and everyone is affected:

- Public schools that serve over 850,000 children have been forced to cut staff, increase class size, reduce course options and eliminate important services.
- University and technical colleges have had to raise tuition and curtail financial aid for lower income students.
- Fire safety and emergency medical personnel in many communities have been cut.
- Public investment in recreational and cultural activities has dwindled.
- Community programs designed to help persons with various disabilities are being reduced or eliminated.

Unfortunately, the list goes on.

Why are communities facing this loss of vital services? The main problem is at the state level. State aid for local governments and schools has not kept pace with needs. Even if the dollar amount allocated for public systems is higher from year to year, the amounts are substantially less than the increases in the costs to continue quality programming in education, sanitation, transportation, public safety and many other critical areas.

Some of the shortfall in state support is filled by raising local property taxes, which have grown beyond the capacity of many homeowners and small businesses. The rest of the revenue gap is not covered, and thus leads to program cuts. Wisconsin families are paying higher property taxes for services that are diminishing before their eyes. One of the main political conflicts in every community

is the debate and blame-passing that occurs among various constituencies: angry property taxpayers refusing to pay more; advocates for public programs demanding increased investment; elected officials trying to lower costs by reducing employee benefit packages and privatizing functions; and frustrated public sector workers who bargained away wage increases in recent years in order to hold onto quality health care and pension benefits.

These increasingly bitter conflicts are premised on the assumption that there is not enough money to cover the cost of doing business. This leaves only the choice between higher property taxes or cuts in public services. However, the assumption is incorrect and the choice is false. There is potential revenue available to cover the cost of quality public structures without raising property taxes. The money is there, if the state revenue base is expanded to include a greater contribution from those who now fail to pay their fair share.

This report will analyze the declining share of state revenue that comes from the corporate sector, particularly corporate income tax. In 2006, there was a shortfall of \$643 million in state corporate income tax payments through tax exemptions, credits and loopholes. In the same year, the corporate contribution to state and local revenues was \$1.3 billion less than it would have been if only the corporate share of taxes here were at the US average. Indeed, the Wisconsin Department of Revenue reports that in 2005, 66.5% of all corporations filing state tax returns showed zero tax liability and paid nothing.

Since this corporate revenue gap helps undermine financial support for critical state and local services, it can play a significant role in blocking Wisconsin's economic progress. Thus it is crucial that policymakers and taxpayers have a comprehensive analysis of why this corporate revenue gap exists, how much it is costing the state, which corporations are shirking their fiscal responsibility and how the state can address the problem.

This report utilizes state and national data as a basis for assessing the scope and impact of corporations' failure to contribute adequately to the public coffers. This is a first step in the process of designing and enacting changes in the state tax structure that ensure sufficient revenue for strong public structures without overtaxing homeowners and small-business owners.

1. The decline in state corporate income taxes

The corporate income tax has been a dwindling portion of Wisconsin tax revenues over the years. During the decade from 1996 to 2006, for example, total personal income taxes rose 47%, sales taxes rose 52% and homeowner property taxes grew 62%. But corporate income taxes grew only 23%.¹ Households are bearing an increasing tax burden through income, sales and residential property taxes.

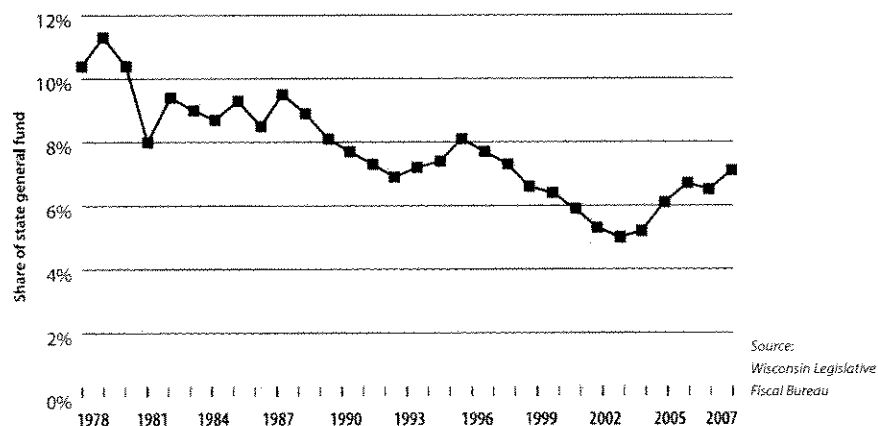
Even the apparent increase in the dollar value of corporate income taxes is misleading, as is clear when the figures are adjusted for inflation. The result of adjusting for inflation is a long-term trend that is basically flat. For example, in 1978 corporate income tax receipts as measured in 2007 dollars were \$913 million. In 2007 they were \$890 million.² There was absolutely no growth in inflation-adjusted dollars in the intervening three decades.

Corporate profits, on the other hand, grew during that time period in both nominal and inflation-adjusted dollars. From 1978 to 2005, nationwide corporate profits more than doubled when adjusted for inflation, from \$694 billion to \$1.446 trillion.³ The contrast between the flat performance of state corporate income tax receipts and a doubling of profits highlights a dramatic underpayment of state income taxes relative to the size of overall profits.

This is reflected in the long-term decline in the corporate income tax contribution to state revenues. In 1980, for example, the corporate income tax provided 10.4% of the state's general funds. By 2002 this had fallen to 5.0%. Since 2002 the figure has rebounded some as the economy recovered from recession, but by 2007 had returned only to 7.1%.⁴ (See Chart 1.)

CHART 1

Corporate income tax is a declining share of state general fund revenue



There are ups and downs in the corporate income tax share, due to profit cycles in the overall economy, but the long-term trend is unmistakably down.

The problem is hardly restricted to Wisconsin, but has been documented in many states. As Michael Mazerov wrote: "During the past several years, there has been a growing awareness and concern among state policymakers and fiscal analysts that the state corporate income tax is in a state of declining health."⁵ Among his many citations, Mazerov quotes a Congressional Research Service report that the effective rate of state corporate income tax was slashed in half, from 8.5% in 1986 to 4.2% in 2004.

2. 'Leakage': Where did the \$643 million go?

Exactly how much potential state tax revenue is lost? In a recent article in *State Tax Notes*,⁶ Martin A. Sullivan develops the concept of **corporate tax leakage** to estimate state corporate income tax losses due to loopholes and other legal tax avoidance mechanisms on a state-by-state basis. Estimated leakage in Wisconsin's corporate income tax system in 2006 was \$643 million. For the period 1999-2006, it is estimated that Wisconsin's total corporate tax leakage was \$1.828 billion.

The starting point for the idea of leakage is that corporations define profits differently on their federal tax returns and their state returns. There is an average gap nationally of about 22% between what corporations report on their federal returns and what they report on their returns to the various states. The actual shortfall differs from state to state, based on each state's particular tax laws, the specific corporations filing returns in each state and their tax avoidance strategies.

Using this analysis, if profits reported to all the states had been the same as profits reported at the federal level in 2006, Sullivan reports, it would have meant an additional \$14.5 billion in state corporate income tax revenue. Wisconsin's portion of that amount is \$643 million.

The difference between what corporations report on their Wisconsin income tax returns and what they report on their federal returns is the result of leaks consisting of "exclusions, deductions, and credits and of planning opportunities beyond those available in the federal corporate tax system." The \$643 million is the amount that would have been paid in Wisconsin corporate income tax if the state "plugged those leaks so that [its] tax bases were as broad, and tax avoidance opportunities as few, as exist at the federal level."⁷

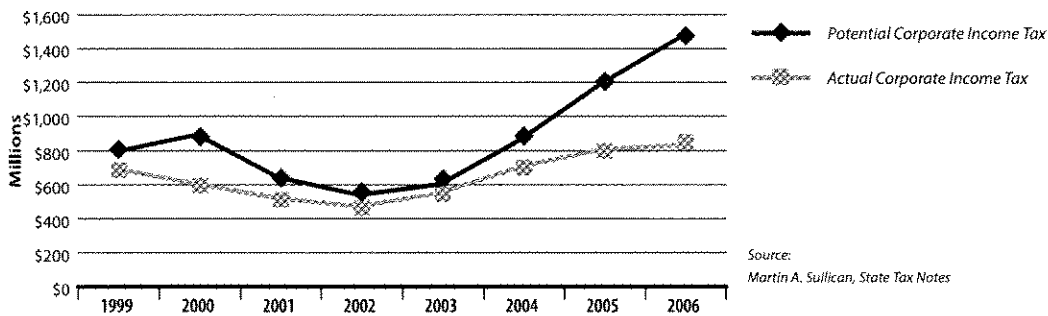
Particularly alarming is that Wisconsin's corporate tax leakage is not only large but has grown rapidly for the last three years, while corporate profits rebounded from the 2001 recession. Wisconsin's corporate tax leakage grew from \$50 million in 2003 to \$161 million in 2004, \$391 million in 2005,

and then \$643 million in 2006. (See Chart 2.) There has been a “substantial increase in the leakiness of state corporate taxes vis-à-vis the federal tax” in the years since the 2001 recession, Sullivan notes, as many corporations became increasingly aggressive in their use of loopholes.

CHART 2

Wisconsin corporate tax leakage

Growing gap between potential and actual taxes



This is the specific methodology used to calculate corporate tax leakage:

1. It begins with a calculation of total corporate profits reported on federal tax returns, by using data on total top federal corporate income taxes and dividing by the federal corporate tax rate of 35%. For example, if total income taxes were \$35 million, this implies total reported profits of \$100 million taxed at 35%.
2. Then, corporate profits as reported to the federal government are apportioned to individual states using the federally determined Gross Domestic Product (GDP) for each state and for the country as a whole. Wisconsin's state GDP was 1.73% of the nation's GDP in 2006, so corporate profits in Wisconsin are assumed to be 1.73% of national corporate profits.
3. Having thus estimated corporate profits in Wisconsin (that is, profits as they were reported to the federal government), the state's 7.9% corporate income tax rate is used to calculate what state tax revenues would be. This is the corporate income tax that would be paid **if** corporations reported to the state's Department of Revenue the same profits they reported to the federal Internal Revenue Service.
4. Finally, leakage is determined by subtracting actual state corporate income tax payments from the potential payments calculated in step #3. In 2006, for example, actual tax payments in Wisconsin were \$808 million. Potential payments were \$1.451 billion. The difference between the two is the \$643 million in leakage due to various tax avoidance strategies.

From 1999 through 2006, Wisconsin's total potential corporate income tax receipts were \$6.817 billion. Actual taxes were \$4.989 billion. The difference of \$1.828 billion represents the total corporate tax leakage during that period.⁸

If Wisconsin's GDP in 2006 was 1.73% of the nation's, is it plausible to assume that corporate profits in Wisconsin were 1.73% of nationwide corporate profits? There is no direct way of measuring corporate profits in Wisconsin because the only data on actual state profits are based on state tax filings. Determining state profits as if they were reported consistent with IRS reporting is based on the assumption that Wisconsin is equally profitable to do business in as the nation as a whole.

Wisconsin's overall economy has in fact remained generally on pace with the national economy. One measure of profitability in Wisconsin is in the BizTimes Stock Index created by the *Small Business Times* and North Shore Bank.⁹ This stock index "is based on prices of publicly traded stocks of nationally listed companies headquartered in Southeastern Wisconsin." This index can be used as a proxy for Wall Street's evaluation of Wisconsin-based firms and by extension, an evaluation of the profitability of doing business in Wisconsin.

From January 1, 2000 through December 7, 2007, the BizTimes Stock Index rose 74%. This is better performance than registered by well-known national stock indexes. For example, during the same time period, the S&P 500 Index increased 2%. The Dow Jones Industrial Average increased 19%. The Nasdaq Composite Index fell 33%. And the Russell 2000 grew 58%.

These figures support the assumption that Wisconsin's profits are at least on par with the national average, which leads to the estimate of corporate tax leakage of \$643 million in 2006.

3. The corporate share of all state and local taxes: \$1.3 billion missing

There are many taxes paid by business besides the income tax, including the state corporate income tax, state and local sales taxes, and local property taxes of various kinds. A good source of data about business taxes in general is Ernst & Young's annual review of state and local taxes for businesses: *Total State and Local Business Taxes*.¹⁰ Ernst & Young is the second largest accounting firm in the US, and it prepares the books for many of Wisconsin's largest companies. The firm is in a good position to understand the complexities of calculating overall tax levels.

Ernst & Young's calculations include property taxes of all kinds; sales and use taxes paid by businesses on purchases of inputs; corporate income taxes; excise taxes on business purchases; taxes on insurance premiums and utility receipts; unemployment taxes; license taxes; and individual income taxes paid by owners of pass-through entities (such as partnerships, sole proprietorships and S-corporations).

The Ernst & Young report estimates that in 2006, Wisconsin's business sector paid 35% of all state taxes. The nationwide average contribution by business to state taxes is 40%. If Wisconsin's corporate community paid an additional five percentage points, enough to bring it up to the US average, it would mean \$800 million in additional business taxes.

It's the same story for local taxes. In Wisconsin, the business sector paid 47% of all local taxes, according to Ernst & Young. The nationwide average contribution by business to local taxes is 52%. The difference amounted to \$500 million lost to the local revenue pool. These taxes were paid by individuals rather than the corporate sector.

Combining state and local tax losses yields the conclusion that Wisconsin's corporate community underpays state and local taxes by more than \$1.3 billion each year. This is the difference between what the business sector actually pays in state and local taxes, and what it would be paying if only its share of taxes equaled the average share paid by business nationwide. As a taxpaying partner in supporting state and local services, Wisconsin's corporate sector ranks 41st among all the states, according to Ernst & Young.

4. Corporations: Size matters

The focus of this tax analysis is on the very largest corporations. "Very largest" refers primarily to mega-corporations with publicly traded stock, which do business in multiple states and often multiple countries. According to the Wisconsin Department of Revenue, in 2005 there were 48,600 corporations doing enough business in Wisconsin to file a state income tax return. Of these, 4,237 had total receipts of over \$100 million (total receipts from all jurisdictions, not just Wisconsin).

Size is important because the very large multi-state corporations have tax-avoidance capabilities that smaller firms or firms doing business only in Wisconsin don't have. Companies with operations in many states are able to shift profits internally from one state to another, choosing the state with the most lenient tax policies. Very large companies are able to afford the legal and accounting talent necessary to practice many of the tax-avoidance techniques. This helps explain why, of the 4,237 largest firms filing tax returns in Wisconsin, 56% reported owing zero in corporate income tax.

5. Who pays? Who doesn't?

In 2006, the Institute for Wisconsin's Future (IWF) began to investigate which specific corporations were and were not paying income taxes. The process for obtaining company-specific data on Wisconsin income tax payments is both bizarre and baroque.¹¹ It is done by submitting a Form P-100 to the Department of Revenue, with a separate application for each specific company. Requests must be exactly correct: corporations are to be listed using the same name and address used in the

corporate tax return. Almost all large companies have numerous subsidiaries, which would require multiple requests. Each request must be notarized and accompanied by a four dollar fee for each tax year. Waiting times to receive back information are approximately two months. The Department of Revenue, simultaneous with its return of information to the filer of the Form P-100, notifies the corporation of the request, the identity of the requester and the purpose of the request.

Perhaps the most bizarre aspect of the current law is that once data have been obtained in this method, it is illegal for the researcher to divulge the information obtained. Fortunately for the public, there are two exemptions to the ban on reporting the data: They can be released in the course of making a public address or can be printed in a newspaper. In order to meet these requirements, then, IWF was unable to distribute any of the information in writing. To be made public, it had to be released only during a public address. For IWF to be able to put any of the information in writing, it had to first be published in a newspaper which relied on the release during the public address. Direct release from IWF to the newspaper, other than during the course of a public address, appears to be prohibited. All this requires an elaborate choreography in order to make any of the data available to the public.

The time involved in waiting for information, the expense of filing multiple reports, and the difficulties in making the information public all combine to severely restrict the public's access to accurate information about company-specific income tax payments. The requirement that individual subsidiaries be correctly identified and that each be the subject of a separate filing further restrict the ability of researchers to gain a complete understanding of any one large corporation's state income tax payments.

Some of the results of that process can be found in Tables 1, 2, 3 and 4. The tax payments listed there are the most recent figures obtained through the process that have already been reported in a public address and reprinted in a newspaper. Most recent data that have been obtained by IWF cannot yet be reported, until they have been mentioned in a public address and subsequently printed in a newspaper. Three examples that can be printed are Microsoft, Merck and Sears. In 2005, the three generated combined profits of over \$18 billion, yet none of the three paid a penny in Wisconsin corporate income tax.

Table 1 gives income tax payments of various major public companies not based in Wisconsin. Table 2 gives income tax payments of some public companies based in Wisconsin. Table 3 gives income tax payments of companies with executives serving at the time on the board of directors of Wisconsin Manufacturers & Commerce (WMC). WMC was selected because it is the largest lobbying organization in the state and devotes considerable resources in an effort to reduce taxes of all kinds, including business taxes. WMC is active both in lobbying and in support of political candidates and is well-known for its work in support of tax-cutting proposals.

**TABLE 1 Wisconsin corporate income tax —
National companies**

	2003	2004
Coca-Cola	\$596,532	\$1,158,471
Deere & Co.	\$0	no data
Emerson	\$0	\$0
Exxon Mobil	\$913,726	\$1,529,372
General Electric	\$0	\$0
Home Depot	\$1,161,896	\$2,420,506
Kimberly-Clark	\$0	no data
McDonald's	\$0	no data
Merck	\$0	\$0
Microsoft	\$0	no data
Pepsico	\$0	\$0
Stora Enso (North America)	\$0	\$0

Source: Wisconsin Department of Revenue

**TABLE 2 Wisconsin corporate income tax
Wisconsin companies**

	2003	2004
A.O. Smith	\$0	\$0
Actuant	\$0	no data
Badger Paper	\$0	\$0
Brady	\$0	no data
Briggs & Stratton	\$2,428,975	no data
Bucyrus International	\$0	\$0
Fiserv	\$0	no data
Gehl	\$0	\$0
Harley-Davidson Motor Co.	\$2,408,911	\$3,355,696
Harley-Davidson Motor Company Group	\$7,985,652	\$20,233,568
Harley-Davidson Motor Company Operations	\$2,387,208	\$3,007,262
Johnson Controls	\$0	no data
Johnson Controls Battery Group	\$0	\$0
Joy Global	\$0	no data
Kohl's Department Stores	\$1,315,974	\$2,858,393
Ladish	\$0	\$0
Manpower	\$0	\$0
Marten Transport	\$44,479	\$22,734
MGIC Investment	\$0	\$0
Modine Manufacturing	\$74,008	\$278,932
Oshkosh Truck	\$2,619,019	no data
Rockwell Automation	\$0	no data
School Specialty	\$0	\$0
Sensient Technologies	\$0	\$0
Twin Disc	\$0	\$0
Weyco Group	\$806,405	\$1,453,579

Source: Wisconsin Department of Revenue

TABLE 3 Wisconsin corporate income tax
Wisconsin Manufacturers & Commerce board

	2003	2004
Ariens	\$0	\$0
Associated Banc-Corp	\$0	\$0
Badger Meter	\$125,798	\$418,391
Castle-Pierce Printing	\$0	no data
Church Mutual Insurance*	\$309,806	\$340,243
ConAgra	\$0	\$124,234
D&S Manufacturing	\$146,872	\$151,533
Deere & Co.	\$0	no data
Emerson	\$0	\$0
Greenheck Fan	\$0	\$0
Hutchinson Technologies	\$0	\$0
J.P. Cullen & Sons	\$0	\$0
Janesville Sand & Gravel	\$112,558	\$127,409
Lakeside Foods	\$476,069	\$120,236
Market & Johnson	\$0	\$0
Northwestern Mutual*	\$526,689	no data
Quad/Graphics	\$2,675,187	\$2,164,306
Sentry Insurance*	\$1,775,667	\$2,758,965
Serigraph	\$0	\$0
Snap-On	\$0	\$0
The Manitowoc Co.	\$0	\$0
The Swiss Colony	\$320,539	\$470,998
U.S. Bank	\$298,660	\$1,245,559
Wausau Paper	\$0	\$0
Webcrafters	\$0	\$0

Source: Wisconsin Department of Revenue

*Insurance companies also pay state premium tax. NML paid over \$5 million premium tax in 2003.

From the list of national and Wisconsin-based companies, it is clear that a decision to pay income taxes in Wisconsin is exactly that: a decision. Some companies pay taxes, others do not. What distinguishes Coca-Cola, which pays, from PepsiCo, which doesn't? Presumably the difference is a matter of tax strategies. It makes no sense, however, to have a tax system in which individual companies are able to choose as a matter of internal strategy whether or not to pay taxes.

The list of WMC directors' firms shows that despite the organization's fervent complaints about the Wisconsin business tax climate, a majority literally pay nothing in state income tax. This seems to make a mockery of complaints such as those voiced by WMC Chairman Terry Growcock, chairman and chief executive of The Manitowoc Company, in a newspaper interview during which he "cited what he called **excessive corporate taxation.**"¹² (*emphasis ours*)

6. How does tax revenue leak?

The basic mechanism used by large corporations to avoid or reduce income taxes is internal transfers among several of its subsidiaries. For example, profits can be moved from one state to another, transferring from a higher tax to a lower tax state. Another method involves internal transfers of goods or other assets at inflated prices set by the company simply in order to reduce profits in one higher tax jurisdiction and increase them in another lower tax jurisdiction.

What follows are examples of three kinds of loopholes that companies have used to reduce or eliminate Wisconsin corporate income taxes.

The real estate loophole: The case of Wal-Mart is instructive not only because it is such a dominant company in Wisconsin and nationwide, but because its state tax avoidance strategies have been well documented in *The Wall Street Journal*.¹³

When Wisconsin tax information on Wal-Mart was first obtained from the Department of Revenue, it turned out the company was one of the minority among large firms actually paying some corporate income tax. For example, in 2003 Wal-Mart Stores paid \$547,096 in income tax. However, on further examination, it became clear that the amount the retail giant was paying was well below what was plausible based on the extent of its Wisconsin operations.

Using the \$547,096 in taxes paid combined with the state's corporate income tax rate of 7.9% allows a calculation of what Wal-Mart declared as Wisconsin profits. The total declared profits, on which the firm paid income taxes, were \$6.9 million. But on national reports, Wal-Mart reported its total company-wide profits that year at \$9.054 billion. Wisconsin, of course, accounts for only a sliver of that. But how big a sliver?

Wal-Mart's web site says that Wisconsin has 49 of the company's approximately 1,100 "super centers," 28 of the company's approximately 1,950 "discount stores," and 12 of its approximately 575 "Sam's Clubs." Combined, this gives Wisconsin 89 Wal-Mart facilities. This is 2.4% of Wal-Mart's US total.

If Wisconsin houses 2.4% of Wal-Mart stores, it's plausible that it brings in approximately 2.4% of Wal-Mart's profits. Its 2003 company-wide profits were \$9.05 billion. So, Wisconsin's contribution to those profits would be on the order of \$220 million. Yet Wal-Mart's declared profit in Wisconsin, as seen above, was only about \$7 million — only a fraction of the estimated \$220 million. If Wal-Mart's Wisconsin profits were actually \$220 million, its corporate income tax would be more than \$15 million. Instead it paid \$547,096, apparently a sizable tax leak in that year.

In April 2007, *The Wall Street Journal* reported on Wal-Mart's widespread use of real estate investment trusts as a technique for avoiding state income taxes. The company used one subsidiary, Wal-Mart Stores Inc., to

2007 + 7.9% = 199,539
 199,539 / 7.9% = 25,259,367
 25,259,367 - 199,539 = 25,059,828

operate stores. And it used a separate subsidiary, Wal-Mart Real Estate Business Trust, to own the facilities. Wal-Mart Stores then paid rent to Wal-Mart Real Estate Business Trust. But the rent payments were so high that the stores were left with little to no profit on which state taxes had to be paid. The profits had in effect been transferred to Wal-Mart Real Estate Business Trust. But that company had been organized under federal tax laws which allowed it to pay out its profits without paying state or federal income taxes.

In April 2007, IWF reported its findings about Wal-Mart, which were cited in various press accounts, including a column by Mike Ivey in *The Capital Times* (Madison). Wal-Mart reacted quickly to Ivey's column, with a reply published in a subsequent issue of the paper.¹⁴

Wal-Mart spokeswoman Judy Evans confirmed Wal-Mart's use of the real estate strategy as a means to avoid state taxes. She wrote:

The issue is about Wal-Mart's use of a Real Estate Investment Trust to manage 84 of the 89 stores and clubs we operate in Wisconsin. The REIT, as it is called, relieves store managers of the burden of day-to-day real estate management and simplifies financing activities. We use the REIT structure in 46 states, and in 16 of them — including Wisconsin — it provides a substantial tax benefit.

The Las Vegas loophole: In this maneuver, a Wisconsin bank creates a subsidiary firm in Nevada, a state without a corporate income tax. Through internal bookkeeping arrangements, Wisconsin profits are transferred to the Nevada operation. This leaves the Wisconsin banks profit-free — hence free of any state corporate income tax obligation.

In 2003, the Madison *Capital Times* newspaper reported that the Department of Revenue estimated “over 80% of state banks have established subsidiaries in Nevada.”¹⁵ The state challenged the use of the Las Vegas loophole, and after lengthy negotiations, settlements were reached between many banks and the Department of Revenue. The department said back tax payments were made and bank practices altered, but would not disclose any settlement details.

IWF made efforts to use data requests to the Department of Revenue to determine whether banks were continuing to use the Las Vegas loophole after the reported settlements. Indeed, in many cases it appears that banks had begun paying income tax. See Table 4 for data on a number of banks. It is clear that some banks appeared to have begun paying income taxes consistent with the time period for which they were in settlement talks with the state. One notable exception is Associated Banc-Corp, the state's second largest bank system. According to the Department of Revenue data, there was zero income tax paid from 2001 through 2004 (the most recent data available) by Associated Banc-Corp (the parent holding company), Associated Bank (the system's largest individual bank), or Associated Trust Co. (the large wealth management subsidiary).

In the absence of comprehensive corporate tax data, it is not possible to know how many banking organizations in the state continue to use the Las Vegas loophole and how many have begun paying taxes. Nor is it clear, for those that are paying taxes, whether the Las Vegas loophole is being used to shield a portion of the Wisconsin profits.

TABLE 4 Wisconsin corporate income tax
Wisconsin banks: Some settlements of Las Vegas loophole case?

	2000	2001	2002	2003	2004
AnchorBank	\$728,983	\$0	\$2,159,170	\$2,450,690	no data
Associated Banc-Corp	\$0	\$0	\$0	\$0	\$0
Associated Bank	no data	no data	\$0	\$0	no data
Associated Trust Co.	\$151,003	\$0	\$0	\$0	\$0
Business Bank (Appleton)	\$0	\$0	\$31,417	\$95,685	\$229,083
Charter Bank Eau Claire	\$0	\$48,990	\$254,131	\$428,221	\$660,713
First Banking Center	\$0	\$0	\$0	\$0	\$632,784
First Business Bank-Madison	\$0	\$0	\$0	\$0	\$0
First Business Bank-Milwaukee	\$0	\$0	\$0	\$0	\$0
First National Bank in Manitowoc	\$0	\$0	\$0	\$181,304	\$418,352
Great Midwest Bank	\$0	\$178,197	\$491,450	\$456,682	\$33,068
M&I Marshall & Ilsley Bank	\$1,173,789	\$3,350,103	\$3,716,112	\$5,464,139	no data
Marshall & Ilsley Corp.	\$6,032,124	\$295,255	\$0	\$0	\$0
Marshall & Ilsley Trust Co.	\$2,560,830	\$2,266,981	\$1,896,708	\$2,001,897	\$1,141,303
National Exchange Bank	\$0	\$0	\$0	\$0	\$1,196,746
Ozaukee Bank	\$0	\$0	\$306,246	\$671,951	\$542,564
Park Bank	\$0	\$45,242	\$103,908	\$162,360	\$147,986
Peoples Bank of Wisconsin	\$0	\$0	\$0	\$84,105	\$489,402
Wauwatosa Savings Bank	\$0	\$0	\$210,071	\$177,895	\$338,161

Source: Wisconsin Department of Revenue

The logo loophole: For a number of years, Kohl's required its department stores in Wisconsin to pay royalty fees to an out-of-state firm for the rights to use various Kohl's trademarks. The out-of-state firm, however, was simply another subsidiary of the parent Kohl's Corp.

In 2002, the state's Department of Revenue demanded Kohl's repay more than \$800,000 in unpaid state taxes and interest. The case was ultimately settled in 2003 without going to court, but the terms of the settlement have been secret, as have Kohl's subsequent tax payments.¹⁶

This was an example of a widely used tax-avoidance strategy most notoriously utilized by Toys R Us for its "Geoffrey" the giraffe logo, which was owned by a Delaware subsidiary of the parent firm. Published reports have named dozens of national companies that have used a similar technique, including such well-known firms as Burger King, Home Depot, The Limited, Radio Shack and others.¹⁷

Summary and Conclusion

Wisconsin's economic future hinges on the capacity of the state to attract and build on investments of financial and human capital. Business leaders and the talented people they need are looking for environments that enhance production, support family life and nurture individual lifestyles. Communities cannot meet these expectations without a full and effective network of public structures that ensure families and business groups smooth transportation systems, excellent education, safe streets, clean air and water, diverse recreation and cultural opportunities as well as well-managed judicial and human services. 'Corporate tax leakage' in Wisconsin is jeopardizing the state's ability to afford these vital public operations.

Corporate tax leakage is the loss of income tax revenue from the largest corporations in Wisconsin. These multi-state, multi-national corporations are using a variety of tax breaks, loopholes and profit shelters to avoid paying taxes. This leakage is costing state governments hundreds of millions of dollars annually. Total corporate underpayments, involving taxes of all kinds, exceed one billion dollars. The resulting gap in revenue is creating budget shortfalls which can only be resolved by cutting services or raising property taxes or both. At the local level, cities, counties and school districts have been forced to reduce or eliminate a wide range of programs including fire safety, emergency services, road maintenance, mass transit, schools, technical colleges, the state university system, parks, the arts and services for the most vulnerable. Simultaneously, property taxes consistently go up.

Specific research on corporate income tax reveals that almost two out of three megacorporations in the state pay no income tax at all. Some who do, pay an amount far below what is warranted by the profits they make in the state. This pattern of income tax avoidance is difficult to track and deal with because corporate tax information is not accessible to the public. Complicated and costly procedures are required to collect the information and it is illegal to release data to the public except through elaborate procedures. This haze of secrecy prevents policymakers and taxpayers from examining tax policies and their impact on communities and the state as a whole.

The majority of tax policy attention is focused on property taxes which are among the highest in the United States. The bitter debates about property taxes take place within a faulty context that assumes there is no other source of revenue to cover the actual costs of maintaining and even strengthening the system of public structures needed for long-term prosperity. The analysis of large corporations' tax contributions to the Wisconsin resource pool is crucial to develop state tax policies that ensure adequate revenue for growth collected in a way that is fair to all sectors of society.

A first step in this process is opening the files on corporate taxes so that all parties in the planning process share the same information. Transparency in financial procedures is crucial in making informed decisions and designing revenue systems that ensure growth and sustainability. This requires changes in state law so that full and frank corporate tax disclosure is possible.¹⁸ Tax facts are a tool for mediating the needs of households, corporations, small businesses and public sector entities so policymakers can find and implement revenue policies that guarantee the optimum outcome for the future.

¹Wisconsin Legislative Reference Bureau; State of Wisconsin *Blue Book*.

² Wisconsin Legislative Reference Bureau

³ US Bureau of Economic Analysis

⁴ Wisconsin Legislative Fiscal Bureau

⁵ Michael Mazerov, *State Corporate Tax Disclosure: The Next Step in Corporate Tax Reform*. Center on Budget and Policy Priorities, 2007

⁶ Martin A. Sullivan, "State Corporate Tax Leakage: \$14.5 Billion in 2006," *State Tax Notes*, Nov. 26, 2007

⁷ Sullivan, p.601

⁸ There are various ways businesses can be legally organized, other than as a traditional so-called C-corporation. For example, there are also S-corporations, Limited Liability Companies (LLC) and sole proprietorships. Because the starting point of this analysis is profits and taxes only for C-corporations, the impact of S-corporations has been removed. It is not possible to explain the corporate leakage by appealing to the recent growth of S-corporations, which has allowed some smaller companies to shift from paying taxes as corporations to owners paying taxes as individuals.

⁹ *Small Business Times* (www.biztimes.com)

¹⁰ Robert Cline, Tom Neubig and Andrew Phillips, *Total State and local Business Taxes: 50-State Estimates for Fiscal Year 2006*, Ernst & Young LLP in conjunction with the Council on State Taxation)

¹¹ Wisconsin Statutes 71.78

¹² Charlie Mathews, "Growcock plans to cheerlead, but not run from challenges," *Manitowoc Herald-Times*, Jan. 15, 2006.

¹³ Jesse Drucker, "Wal-Mart Cuts Taxes by Paying Rent to Itself," *The Wall Street Journal*, Feb. 1, 2007. Jesse Drucker, "Inside Wal-Mart's Bid To Slash State Taxes," *The Wall Street Journal*, Oct. 23, 2007

¹⁴ Mike Ivey, "Wal-Mart: The low-tax leader, always," *The Capital Times*, April 24, 2007. Judy Evans, "Wal-Mart article was irresponsible," *The Capital Times*, April 30, 2007.

¹⁵ Mike Ivey, "Tax Shelters Costs States Billions," *The Capital Times*, July 16, 2003.

¹⁶ Mike Ivey, "State Takes Kohl's Corp. to Court in Pivotal Tax Case," *The Capital Times*, May 14, 2003. Mike Ivey, "Black: Expose Corporate Tax Dodge," *The Capital Times*, April 15, 2004.

¹⁷ Glenn Simpson, "A Tax Maneuver in Delaware Puts Squeeze on Other States," *The Wall Street Journal*, Aug. 9, 2002.

¹⁸ One proposed example is the *Corporate Tax Accountability Act (SB367)* introduced in the Wisconsin State Senate by Sen. Dave Hansen in December 2007. For details on corporate income tax disclosure, see: Kate Gordon and Kyle Hanniman, *Corporate Tax and Subsidy Disclosure: Policy Options for Wisconsin*, Center on Wisconsin Strategy, June 2007. [cows.org/about_publications_detail.asp?id=416]; and Michael Mazerov, *State Corporate Tax Disclosure: The Next Step in Corporate Tax Reform*, Center on Budget and Policy Priorities, February 2007. (www.cbpp.org/2-13-07sfp.htm)

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